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SPECIAL NUMBER

ADDITIONAL REGULATIONS

of the

United States Treasury Department

RELATIVE TO THE

FEDERAL CORPORATION
TAX RETURNS

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DECISIONS
OF
UNITED STATES TREASURY DEPARTMENT
RELATIVE TO
THE FEDERAL CORPORATION TAX

The cases now before the United States Supreme Court to test the constitutionality of the Federal Corporation Tax Law are assigned for argument on January 3, 1911. Whether the Supreme Court declares the law unconstitutional or not, it is unlikely that the decision will be handed down before the first day of March, 1911, which is the last day on which to file the Federal Corporation Tax Returns for the coming year. Accordingly, for the guidance of counsel and officers of corporations, we present on the following pages Treasury Decisions numbers 1606, 1611 and 1665. The first contains a synopsis of decisions made from time to time prior to March 29, 1910; the second and third being rulings handed down since that date. Treasury decision 1665 embodies the regulations under which the returns of corporations may be inspected. In our Journal No. 15, published in December, 1909, we presented the Regulations prepared by the Treasury Department for the preparation of the first returns under the law. Copies of the same may be had upon request at any of our offices.

(T. D. 1606.)

Special excise tax.

Synopsis of decisions relating to the tax imposed by section 38, act of August 5, 1909, on corporations, etc.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., March 29, 1910.

The following synopsis of decisions made, from time to time, on questions relating to the special excise tax imposed by section 38, act of August 5, 1909, on corporations, joint stock companies, associations, and insurance companies, is published for the information of internal-revenue officers and others concerned.

ROYAL E. CABELL, *Commissioner.*

CLASS OF CORPORATIONS, ETC., SUBJECT TO TAX.

1. The tax imposed by the act applies to all corporations, etc., described, except those specifically exempted, without reference to the kind of business carried on.
2. Every corporation, etc., not specifically enumerated as exempt shall make the return required by law, although its net income during the year may not have exceeded \$5,000.
3. Corporations claiming special exemption should nevertheless make return (in blank if desired) accompanied by a statement setting forth the ground on which exemption is claimed.

4. Corporations, etc., organized during the year or going into liquidation during the year should nevertheless render a sworn return on the prescribed form. The tax imposed, however, is held not to apply to corporations which went out of existence prior to the passage of the act.

5. Where company has dissolved and the required return is not made by its officers, such return will be prepared by Commissioner.

6. Where corporation has gone into bankruptcy, returns in such cases to be made by trustee in bankruptcy.

7. Railroad companies operating leased or purchased lines to include all receipts derived therefrom, and if bonded indebtedness has been assumed may deduct interest thereon to an amount not exceeding its own paid-up capital stock. If such subsidiary companies receive income in the way of rentals, etc., return to be also made by such companies.

8. Corporations, etc., organized under the authority of the United States or any State or Territory thereof, or Alaska or the District of Columbia, to include in their returns not only the income derived from the business carried on within the confines of the United States, but income received from business transacted in any foreign country as well.

9. Corporations having branch or subsidiary companies to include in their returns the income of all such companies.

10. Foreign companies having several branch offices in the United States should each designate one of such branches as its principal office and should also designate the proper officers to make the required return.

11. Where a consolidation of two or more corporations has been effected during the year, and each or any such corporation subsequent to such consolidation collects prior existing debts, each such corporation should make separate return and include therein all such collected debts, as also all income received during the year prior to the date of consolidation.

12. "Principal place of business" is held to mean the principal office where the company keeps its books from which the required return is to be prepared and not the place where the operating plant is located.

13. As the law specifically provides that the tax imposed shall be computed on the net income during each calendar year, returns of income based on any period other than the calendar year cannot be accepted.

14. Full amount of stock, as represented by the par value of the shares issued, to be regarded as the paid-up capital stock, except when such stock is assessable on account of deferred payments, in which case the amount actually paid on such shares will constitute the actual paid-up capital stock of the corporation.

15. Capital stock held to include both preferred and common stock.

16. Surplus and undivided profits not to be included in capital stock.

17. Holding companies known as "Voting trusts," receiving only dividends on stock held, and having no capital stock, etc., not liable.

18. Mutual savings banks having no capital stock not liable to tax imposed. (Opin. Atty. Gen., Feb. 14, 1910.)

19. Cooperative dairies not issuing stock and allowing patrons dividends based on butter-fat in milk furnished not liable.

20. Foreign steamship companies having no office in the United States, whose vessels only occasionally touch at ports in the United States, not regarded as doing business in this country within the meaning of the statute.

21. Companies organized in Porto Rico and not engaged in business in the United States not subject to tax.

22. Corporations owning sugar or other plantations and disposing of the products thereof not entitled to exemption as agricultural organizations.

23. Corporations organized to sell provisions, etc., to stockholders and others not exempted.

24. Corporations organized for the purpose of holding real estate, to make return of income derived from the property so held.

25. National banks do not come within any of the exemptions named in the act.

26. "Agricultural organizations" held not to come within the statutory exemption, unless their chief object is the promotion or advancement of agricultural interest, and no part of the net income inures to the benefit of their stockholders.

27. Mutual Hail Association regarded as an insurance company and not as an agricultural association, and therefore liable to tax.

28. Exemption in favor of fraternal beneficiary associations does not apply to mutual fire insurance companies.

29. Limited partnership, if organized for profit and having a capital stock represented by shares, although no "certificates of stock" are issued, are liable to the tax imposed. (Opin. Atty. Gen., Feb. 14, 1910.)

30. Building and loan associations not exempt if having a capital and loaning to others than members, i. e., if doing a business akin to banking business.

31. Building and loan associations issuing stock on which dividends are guaranteed held to be liable to tax imposed.

32. Interest received on government bonds to be included in gross income. (Opin. Atty. Gen., Jan. 13, 1910.)

33. Returns should be signed and verified by two of the officers designated in the law. Signing of one person holding two such offices not permitted. Agents for foreign steamship companies may sign the required returns, if so authorized by their companies.

34. Returns not required to have corporate seal affixed.

35. Returns filed with deputy collector regarded as having been filed with collector.

36. No form of protest prescribed. Any form of protest sufficient if filed before payment of tax. Right of protest not to be denied.

INVENTORIES, ACCOUNTS, ETC.

37. Where an inventory or its equivalent was not taken at the close of the year 1908, a supplemental statement showing such inventory approximately must be submitted with the return on the regular form. Such supplemental statement shall be verified under oath by the treasurer or principal financial officer submitting the same. (T. D. 1578.)

38. Cost of manufactured articles, or articles in process of manufacture, held to include original cost of materials used, plus cost of labor, etc.

39. Mortgaged real estate should be inventoried at its full value, and amount of mortgage reported as indebtedness.

40. Profits realized on sale of real estate during year, also increase in value of unsold property, to be included in income.

41. Receipts during year from lands sold on installment to be included in gross income for that year.

42. Receipts from sale of patent rights to be included in income.

43. No particular system of bookkeeping or accounting will be required by the Department. However, the business transacted by corporations, etc., must be so recorded that each and every item therein set forth may be readily verified by an examination of the books and accounts where such examination is deemed necessary.

DEDUCTIONS, EXPENSES, ETC.

44. It is immaterial whether the deductions are evidenced by actual disbursements in cash or whether evidenced in such other way as to be properly acknowledged by the corporate officers and so entered on the books as to constitute a liability against the assets of the corporation, etc., making the return.

45. Mortgage indebtedness on real estate, if assumed by the corporation acquiring such real estate, to be included in the indebtedness of the corporation. But if not so assumed and remains only as a lien on the property, interest paid thereon may be deducted as a charge "made as a condition to the continued use or possession of the property." (Opin. Atty. Gen., Feb. 21, 1910.)

46. Cost of erecting building, if included in lease under which property is held by company, is a proper deduction, to be prorated according to time fixed by lease.

47. General expenses, such as coal, ship stores, etc., of foreign steamship companies, to be prorated as provided in act for interest deductions.

48. Amount received by nursery companies from sales of trees, etc., less amount expended for seedlings and young trees, to be included in gross income. Amount expended for labor, salesmen, etc., to be deducted as expenses.

6 49. Commissions allowed salesmen, paid in stock, may be deducted as expense if so charged on books.

50. Sales of stock and bonds are regarded as sales of capital assets and should be so accounted for. (Art. 2, regs. 31.) But proceeds derived from sale of bonds used in defraying ordinary and necessary expenses are a proper deduction in determining the company's net income.

51. Stock issued in payment of property purchased represents capital investments, and notes issued during the year represent indebtedness. Corporate funds applied to the payment of outstanding notes not a proper deduction in ascertaining net income.

52. Amounts expended in betterments or repairs not a proper deduction. A reasonable allowance for depreciation of stock, etc., is permissible.

53. Betterments and repairs not proper deductions as expenses, the former being additions to the capital assets of the company, and the latter being offset by allowance for depreciation.

54. Cost of replacing old rails, structures, etc., not regarded as ordinary and necessary expenses. Depreciation during year will be allowed, however, in such cases.

55. Dividends received by corporations on stock of other corporations whose net income does not exceed \$5,000 is nevertheless a proper deduction under the law. (Opin. Atty. Gen., Jan. 24, 1910.)

56. Dividends received on stock of foreign corporations not subject to tax not a proper deduction.

57. Dividends paid employees in lieu of wages not proper deduction as expenses.

58. Royalties on patent rights to be reported as income. Allowance for depreciation of patents expiring during year, however, will be allowed.

59. Pensions paid or gifts made to employees are gratuities and not "ordinary and necessary expenses."

60. Where allowances on account of salaries are deemed excessive and for the purpose of evading the tax due, investigation will be made, and if the facts warrant prosecution will follow.

61. Interest paid on time deposits and deposits subject to check constitutes a proper deduction from the amount of gross income during the year.

62. Interest on portions of bonded or other indebtedness bearing different rates of interest may be deducted from gross income during the year, provided the aggregate amount of such indebtedness does not exceed the paid-up capital stock of the corporation.

63. Interest paid during the year on notes given prior to January 1, 1909, to be prorated. But interest on notes given in 1909, and payable subsequent to December, 1909, unless charged on the company's books, is not a proper deduction from the income of that year.

64. Interest or taxes accruing prior to the year for which return is made is not a proper deduction from the gross income for that year.

65. Unearned premiums set aside by insurance companies as reserve not to be included as income until earned.

66. Funds set aside by company for insuring their own property not a proper deduction.

67. As the tax imposed is measured by and is not a tax upon the net receipts of corporations, etc., interest received during the year on government bonds is not proper deduction from such income in determining the amount of tax due. (Opin. Atty. Gen., T. D. 1583.)

68. State, county, or municipal taxes paid during the year a proper deduction in ascertaining the net income of corporations.

69. Import duties or taxes if included in arriving at cost of goods are not deductible under the head of taxes paid during the year.

70. Bad debts, if so charged off the company's books during the year, are proper deductions. But such debts if subsequently collected must be treated as income.

DEPRECIATION.

71. Where increase or decrease during the year in the value of real estate acquired in previous years, sold or held for sale, cannot be accurately determined, such increase or decrease may be prorated, as provided by regulations in cases of sale of capital assets.

72. Depreciation in value of mines by the removal of ore, if not otherwise ascertainable, may be prorated as in the case of sales of capital assets.

73. Depreciation in value of mines by the removal of ore, if in excess of 5 per cent of investment, to be explained in return rendered.

74. Estimated depreciation in oil or gas wells, buildings, machinery, etc., to be stated in detail, if exceeding 5 per cent of value as previously inventoried.

75. Corporations leasing mines and paying royalties on ore mined not entitled to deduction for depreciation. But corporations owning mines are entitled to allowance for depreciation based on fair estimate, etc.

76. Removal of timber from timber lands, while depleting the lands to the extent of such removal, is regarded as a charge in the form of assets and not a depreciation within the meaning of the act.

77. Deduction on account of depreciation of property must be based on lifetime of property, its cost, value, and use.

78. Voluntary removal of buildings, etc., for purpose of improvements not regarded as loss or depreciation, and no deduction therefor should be made.

79. Depreciation of company's stock a loss to the stockholders, but not a loss to the company issuing the same, and therefore not a proper deduction.

ROYAL E. CABELL, *Commissioner.*

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(T. D. 1611.)

Excise tax.

Organizations known as "associates," "trusts," or "real-estate trusts" are to be regarded as joint stock companies or associations organized for profit and having a capital stock represented by shares, and are amenable to the provisions of the corporation excise-tax law.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,

Washington, D. C., April 4, 1910.

To collectors of internal revenue, revenue agents, and other internal-revenue officers:

It appears that there are in Massachusetts, and perhaps elsewhere, various organizations known as "associates," "trusts," or "real-estate trusts," which are not organized under a charter but are formed by an agreement and declaration of trust. It appears that the title to the property or business owned or operated by these organizations is vested in one or more trustees, and certificates are issued to parties in interest as are shares of stock of incorporated concerns, the certificates being traded in as are shares of stock and the trustees being elected and their successors chosen as are directors in any corporation regularly chartered. The organization is one for profit and it possesses all of the essential elements of any joint-stock company.

In reply to a request from the Secretary of the Treasury as to the status of these organizations, in regard to the corporation excise-tax provisions of the tariff act of August 5, 1909, the honorable Attorney-General advises that these concerns are joint stock companies or associations organized for profit and having a capital stock represented by shares, and are amenable to the provisions of the corporation excise-tax law.

Collectors of internal revenue, in whose districts there may be located organizations of this character, will see that such organizations comply with the provisions of this law.

ROYAL E. CABELL, *Commissioner.*

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INTERNAL REVENUE.

(T. D. 1665.)

Inspection of returns of corporations—Executive order—Regulations.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,

Washington, D. C., November 28, 1910.

To internal revenue officers and others concerned:

The following executive order, together with regulations signed by the Secretary and approved by the President, relative to the publicity feature of section 38 of the act of August 5, 1909, and amendments thereto, imposing a special excise tax on corporations, etc., is hereby published for your information.

ROYAL E. CABELL, *Commissioner.*

EXECUTIVE ORDER.

Pursuant to the provisions of an act entitled "An act making appropriations for the legislative, executive, and judicial expenses of the Government for the fiscal year ending June thirtieth, nineteen hundred and eleven, and for other purposes," providing, among other things, an appropriation for classifying, indexing, exhibiting, and properly caring for the returns of all corporations required by section thirty-eight of an act entitled "An act to provide revenue, equalize duties, encourage the industries of the United States, and for other purposes," approved August 5, 1909, and further enacting that any and all such returns shall be open to inspection only upon the order of the President under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President (36 I Stat., 494),

It is hereby ordered: That all such returns shall be subject to inspection upon compliance with rules and regulations prescribed by the Secretary of the Treasury and approved by the President, bearing even date herewith.

WM. H. TAFT.

The WHITE HOUSE,
November 25, 1910.

REGULATIONS GOVERNING THE INSPECTION OF RETURNS OF CORPORATIONS MADE IN
ACCORDANCE WITH SECTION 38 OF THE TARIFF ACT OF AUGUST 5, 1909.

TREASURY DEPARTMENT,

Washington, D. C., November 25, 1910.

INSPECTION OF RETURNS.

By section 38 of the tariff act of August 5, 1909, Congress imposed a special excise tax upon all corporations, joint-stock companies, and associations and insurance companies, foreign and domestic, with certain exceptions, engaged in business in the United States, with respect to carrying on or doing such business, and prescribed the method of handling the return of each corporation, as follows:

6. When the assessment shall be made, as provided in this section, the returns, together with any correction thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue and shall constitute public records and be open to inspection as such.

In the act making appropriations for the legislative, executive, and judicial departments of the Government for the fiscal year ending June 30, 1911, there appears this language:

For classifying, indexing, exhibiting, and properly caring for the returns of all corporations, required by section thirty-eight of an act entitled "An act to provide revenue, equalize duties, encourage the industries of the United States, and for other purposes," approved August fifth, nineteen hundred and nine, including the employment, in the District of Columbia, of such clerical and other personal services and for rent of such quarters as may be necessary, twenty-five thousand dollars: *Provided*, That any and all such returns shall be open to inspection only upon the order of the President, under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President.

For the purpose of making effective the legislative intent thus expressed, the President has ordered that all such returns shall be open to inspection under the following rules and regulations:

1. The return of every corporation shall be open to the inspection of the proper officers and employees of the Treasury Department. Where access to any return is desired by an officer or employee of any other department of the Government, an application for permission to inspect such return, setting out the reasons therefor, shall be made in writing, signed by the head of the executive department or other government establishment in which such officer or employee is employed, and transmitted to the Secretary of the Treasury. If, however, the return is desired to be used in any legal proceedings, or to be used in any manner by which any information contained in the return could be made public, or access to any return is desired by any official of any State or Territory of the United States, the application for permission to inspect such return shall be referred to the Attorney-General, and if recommended by him transmitted to the Secretary of the Treasury.

2. The Secretary of the Treasury, at his discretion, upon application to him made, setting forth what constitutes a proper showing of

cause, may permit inspection of the return of any corporation by any bona fide stockholder in such corporation. The person desiring to inspect such return shall make application, in writing, to the Secretary of the Treasury, setting forth the reasons why he should be permitted to make such inspection, and shall attach to his application a certificate signed by the president, or other principal officer, of such corporation, countersigned by the secretary, under the corporate seal of the company, that he is a bona fide stockholder in said company. (Where this certificate cannot be secured, other evidence will be considered by the Secretary of the Treasury to determine the fact whether or not the applicant is a bona fide stockholder and therefore entitled to inspect the return made by such company.) The privilege of inspecting the return of any corporation is personal to the stockholders, and the permission granted by the Secretary to a stockholder to make such inspection cannot be delegated to any other person.

3. The returns of the following corporations shall be open to the inspection of any person upon written application to the Secretary of the Treasury, which application shall set forth briefly and succinctly all facts necessary to enable the Secretary to act upon the request:

(a) The returns of all companies whose stock is listed upon any duly organized and recognized stock exchange within the United States, for the purpose of having its shares dealt in by the public generally.

(b) All corporations whose stock is advertised in the press or offered to the public by the corporation itself for sale. In case of doubt as to whether any company falls within the classification above, the person desiring to see such return should make application, supported by advertisements, prospectus, or such other evidence as he may deem proper to establish the fact that the stock of such corporation is offered for general public sale.

Returns can be seen only in the office of the Commissioner of Internal Revenue, in Washington, D. C. In no case shall any collector, or any other internal-revenue officer outside of the Treasury Department in Washington, permit to be seen any return or furnish any information whatsoever relative to any return or any information secured by him in his official capacity relating to such return.

No provision is made in the law for furnishing a copy of any return to any person, and no copy of any return will be furnished except to the corporation making the return, or its duly constituted attorney.

The provisions herein contained shall be effective on and after the 25th day of November, 1910.

FRANKLIN MACVEAGH,
Secretary of the Treasury.

Approved:

WM. H. TAFT,

The WHITE HOUSE, November 25, 1910.

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